UNITED STATES

ARE WE IN FOR A BUMPY LANDING?

According to the Atlanta Fed GDPNow Estimate, US growth will remain high in Q1 2023 (annualised quarterly growth rate of 3.2%). News on the labour market front also remains good. Everything would be fine if inflation were not also continuing at an elevated pace, arguing for a continuation of the Fed's rate hikes, the effects of which recently challenged certain banking models. Prior to this, we were expecting the tightening of lending standards to lead the economy in to recession. Further tightening would weigh more significantly on activity and ultimately, on inflation. Does this mean that the Fed will reach its terminal rate sooner and at a lower level? Our new forecasts (dated 30 March) duly note this possibility and we now expect the Fed Funds rate to reach 5.25% (upper range) in May (5.75% in July previously).

After the dip in H1 2022, growth rebounded and sustained an elevated rate (around 3% on a quarterly annualised basis in Q3 and Q4 2022), defying the signals of a recession sent by the Conference Board composite leading indicator (6-month change down 7% in annualised terms in February 2023) and, more specifically, the significant inversion of the yield curve (since July 2022 for the difference between the 10-year rate and the 2-year rate).

However, the solidity of growth in Q4 2022 needs to be put into perspective. Just over half can be explained by the positive contribution of changes in business inventories (after two quarters of very negative contributions). Household consumption has lost momentum and exports have fallen (imports have fallen even further, leading to a positive contribution of net exports).

The most negative point, and the weakest link best identified, is the real estate market. Residential investment has fallen for the seventh quarter in a row. This is one of the most visible effects of the ongoing monetary tightening, but not the only one, since the downturn dates back to mid-2021, while the Fed's first rate hike dates back to March 2022. During the subprime crisis, the drop in residential investment was even sharper (almost -60% between Q4 2005 and Q2 2009), but the extent of the decline over the last three quarters is no less spectacular (-5% q/q in Q2, -8% in Q3 and -7% in Q4). Taking a glass half-full view, the increase in non-residential investment remained sustained in Q4 (+0.8% q/q).

Without appearing as a weak link, households are more affected by the inflationary shock than companies. The former lost purchasing power while the latter generally maintained their margin rate in 2022. In terms of debt ratio, the notable point is that the household debt ratio has fallen to the same level as the same ratio for companies, at around 75% of GDP. In terms of confidence, the analysis is made difficult by the large discrepancy, on the household side, between the Conference Board indicator (above its benchmark level of 100) and the University of Michigan survey (very depressed, although it has recovered since its historic trough in mid-2022). On the corporate side, there is also a gap between the manufacturing sector where the signal is negative (ISM business climate index around 2 points below the threshold of 50 from December 2022 to February 2023) and services where the signal is very positive (ISM index at 55 in January and February).

The situation on the labour market remains reassuring, although job creation is gradually losing momentum and the unemployment rate has not fallen since March 2022 (bearing in mind that it only stands at around 3.5%, a record low).

Although debt in the non-financial private sphere is not, at first glance, a concern, the very high level of the public debt ratio is attracting more attention (115% of GDP). And the debate about raising the debt ceiling could generate some stress episodes, but a resolution will be found, even if it is at the last minute. Initial cracks, raising fears of a wider crisis, appeared in the regional banking sphere with the difficulties of the Silicon Valley Bank (SVB). At the time of writing, the risk appears to be contained, with measures having been taken rapidly. However, this should result in a sharper tightening of lending standards than the one already ongoing, which will impact growth. The downside risk also comes from the fact that inflation remains high and disinflation slow, arguing for a continuation of rate hikes. The situation is not out of control as inflation generalization seems interrupted (downward trend of the combined weight of items with above 2% month-over-month inflation in annualised terms). But it has gained in persistence, particularly through the shelter component.

GROWTH & INFLATION

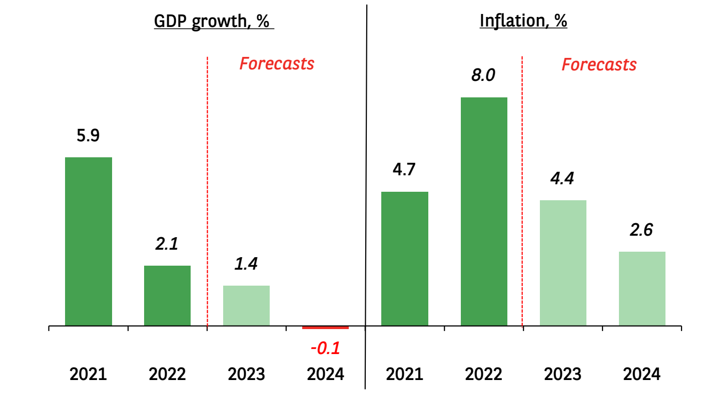

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

Before the SVB shock, we thought that the US economy was heading towards a recession but its signs of resilience had led us to postpone this by one quarter. The expected further tightening in lending standards, following the SVB episode, would slightly accentuate the recession. It would nonetheless remain short (Q3 2023 to Q1 2024) and limited (cumulative drop in GDP of -0.9%). Our growth forecast is 1.4% in 2023 in annual average terms. More optimistic for this year than the March consensus (at about 0.5 points), we are much less optimistic however for 2024. Considering the negative growth carry-over and the negative effects of restrictive monetary policy that are still to come, we expect growth to tip slightly into negative territory this year compared with a consensus of +0.9%.

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